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Iran: The Soviet Bloc As An Economic Alternative

An Intelligence Assessment

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This paper was prepared by Soviet Trade Branch, USSR and Eastern Europe, Office of Economic Research. Comments and queries are welcome and should be addressed to the Chief, Soviet Trade Branch, OER,

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This paper has been coordinated with the Iran Task Force.

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Key Judgments

The publicity given by the Iranian Government to some recent trade deals with and other overtures by the USSR and Eastern Europe greatly exceeds their present or potential economic significance.

With Iranian plant and equipment almost entirely of Western origin and Soviet Bloc countries accounting for only 5 percent of Iranian imports, the USSR and Eastern Europe do not present an attractive alternative to Western goods or markets.

In the event Western Europe and Japan impose economic sanctions, Iran would be neither able nor willing to redirect much of its trade to Soviet Bloc countries:

- Iran's top priority needs are for food and other agricultural products which the Bloc countries would be hard pressed to provide.
- Iran would first attempt to fill its industrial materials requirements through transshipments from third parties, although Communist countries could supply some goods.
- Maintenance of Iran's plant and equipment requires Western-made components.
- Although interested, the Bloc would not be a major market for Iran's exportable oil, in large part because of Soviet and East European hard currency constraints. The USSR could swap its own oil for Iranian oil, exporting the former to the West and consuming the latter domestically or in Eastern Europe.

In the event of a blockade of Iranian ports on the Persian Gulf, Tehran would have no choice but to turn to the USSR to help meet its needs, with overland rail and highway routes handling all Iranian imports. These routes would be put under severe strain just to transport the annual Iranian food requirements of 4 to 5 million tons. Disorganization and civil unrest in Iran have held the flow of goods far below even this level for months. And, even if the Iranian domestic problems could be brought under control, moving increased quantities of goods across the border would require the Soviet Union to divert large numbers of freight cars and other scarce equipment.

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Introduction

Following the EC decision on 22 April to impose sanctions on Iran if "decisive progress" toward releasing the American hostages is not made by mid-May, Tehran announced it was considering turning to the Council for Mutual Economic Assistance (CEMA) countries to replace its traditional Western suppliers. In recent days Iran and the USSR have drafted a new trade agreement and resumed negotiations over the price of gas that Iran supplies to the USSR. Iran reportedly also agreed to increase oil exports to Romania and announced that trade deals with other East European countries are under active discussion.

The publicity given to these developments by the Iranian Government greatly exceeds their present or potential economic significance. Indeed, to date, the Soviet and East European press has been muted in its reporting of expanded links with Iran. This paper addresses the extent to which the Bloc offer a viable alternative to the West as sources of Iranian imports and as markets for Iranian goods. It also considers the capability of the transportation links between the USSR and Iran to carry additional trade in the event of a sea blockade

Iranian-Soviet Bloc Trade in Perspective

Iran imported some $16 billion worth of goods in 1978, of which slightly more than 90 percent came from the OECD countries. In the aftermath of the revolution in 1979, imports fell to about $8 billion with OECD trade accounting for nearly all of the decrease. Food imports ($2 billion in 1978) probably did not change much, while consumer goods imports ($900 million in 1978) likely declined 20 percent, and imports of industrial supplies, capital goods and transport vehicles ($12 billion in 1978) fell about 60 percent. The sharp decline in industrial imports reflects the chaotic state of the Iranian economy and mismanagement rather than a lack of suppliers or funds. Industry was operating at less than 40 percent of prerevolutionary levels for most of the year.*

The USSR Link. Soviet exports to Iran amounted to slightly over $400 million in 1979 and consisted mainly of machinery and equipment—principally motor vehicles, electric power, mining and metallurgical equipment, and food industry machinery. The bulk of these goods went to industrial projects built with Soviet assistance. Soviet imports from Iran—about $200 million last year—consisted almost entirely of Iranian natural gas delivered through the IGAT-1 pipeline. 25X1

Soviet-Iranian trade jumped substantially in the mid-1970s. In 1975, the two countries signed a 15-year economic cooperation pact calling for $3 billion in joir 25X1 projects and the establishment of a commission to expand trade. A year later, the USSR and Iran signed a five-year trade agreement, and Tehran gave the USSR more than $1 billion in commercial contracts. As a result, Iran quickly became the largest Third World market for Soviet goods—a position Tehran lost only when the Iranian revolution closed the border to Soviet shipments and forced the withdrawal of some 25X1 4,000 Soviet technicians in late 1978. 25X1

Soviet exports fell from a peak of about $635 million in 1978 because of the downturn in Iranian industrial activities. Soviet imports dropped from a similar record level of $350 million in 1978 due to a 60 to 70-percent cut in gas deliveries associated with declining Iranian oil production. A major cooperation project also fell through when the Khomeini regime canceled construction of the IGAT-2 pipeline after $700 million in construction had been completed. This transmission line would have delivered 600 billion cubic feet of gas annually to the USSR beginning in 1981 which in turn would have released 125 billion cubic feet of Soviet gas for shipment to Czechoslovakia and 400 billion cubic feet to Western Europe. 25X1

Until events of the past several weeks, Soviet-Iranian trade relations had been chilled by disputes over gas pricing. Talks were suspended in March after Moscow balked at Tehran's demands for a fourfold increase ir 25X1 price from 76 cents to $3.80 per thousand cubic feet. 25X1

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Table 1 Million US $

Iran: Imports [1]

	Total	Food-stuffs	Raw Materials	Fuels	Chemicals	Semifinished Products	Machinery	Transport	Consumer Goods	Other
Total	16,500	NA	NA	NA	NA	NA	NA	NA	NA	NA
Of which: OECD	15,163	1,004	265	47	994	3,359	5,456	1,928	659	1,451
US	3,684	582	47	10	114	186	914	537	83	1,211
Japan	2,691	6	71	1	74	1,165	853	360	152	9
France	889	116	7	4	56	181	300	181	43	1
Italy	1,069	4	12	7	108	310	402	120	106	0
UK	1,430	31	18	3	138	209	563	272	64	132
West Germany	3,381	53	35	16	254	657	1,909	312	97	48
Other	2,019	212	75	6	250	651	515	146	114	50

[1] F.o.b. Based on partner-country trade data. Annual data may be incomplete for some reporting countries.
NA—Not available.

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Claiming losses of $130 million a year from Soviet gas trade, the Iranians closed down IGAT-1. Tehran also threatened to review ongoing industrial construction links with the USSR and hinted that some projects would be canceled.

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Table 2 Million US $

USSR: Trade with Iran

	1977	1978	1979
Exports to, f.o.b.	**577**	**636**	**416**
Machinery and equipment	232	226	
Of which:			
Transportation equipment	82	31	
Power engineering equipment	46	79	
Food industry equipment	39	28	
Mineral extraction equipment	10	15	
Metallurgical equipment	9	8	
Rolled ferrous metals	3	4	
Chemicals	2	1	
Cement	16	16	
Lumber and paper	24	19	
Cotton and cotton fabrics	4	1	
Other	296	369	
Imports from, f.o.b.	**385**	**350**	**210**
Lead and zinc ores	31	26	
Cotton fiber	38	29	
Hides and leather	0	11	
Industrial consumer goods	36	35	
Other [1]	280	249	

[1] Primarily natural gas.

The Soviet Bloc As An Alternative

Under normal circumstances little economic basis would exist for substantially expanded trade between Iran and the Soviet Bloc countries. In the absence of economic sanctions, Iran could buy what it needs from Western countries. As for oil, both the USSR and Eastern Europe would welcome access to new energy supplies. However, they have neither sufficient amounts of hard currency nor products of competitive quality to purchase large volumes of oil. 25X1

If Western Europe and Japan impose economic sanctions on Iran, the Bloc would become a more attractive trading partner, but even then Tehran would probably first seek access to Western goods either through Third World countries or trade intermediaries. Denial measures accompanied with a sea blockade would of course leave Iran little choice but to turn to the Bloc. In such a circumstance, however, overland transport bottlenecks would constrain trade. 25X1

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Soviet Bloc Supply Potential

Iran's top priority needs are for food and other agricultural products. The country normally imports 25 to 30 percent of its food and feed requirements—4 to 5 million tons—with wheat and rice the main products. Iran may already have received 600,000 tons of the 1.3 to 1.5 million tons of wheat required this year. Tehran has contracted for about one-half of the 400,000 to 500,000 tons of rice needed. 25X1

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The USSR and Eastern Europe would be hard pressed to cover any Iranian food shortfalls this year. The combination of last year's poor crop and the US grain embargo have left the USSR substantially short of its needs. Non-US grain availabilities are insufficient to cover Soviet demand let alone additional requirements for Iran, and much of Eastern Europe's exportable surplus is already committed to the USSR. Eastern Europe may be able to help out with added sales of red meat and poultry, but at the expense of domestic consumption and other exports. 25X1

In the longer term there appears to be some latitude to expand Soviet Bloc food sales to Iran. But while Eastern Europe would look favorably on expanding exports, especially of semiprocessed food products, it cannot make long-term commitments of grain and other raw products. 25X1

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In the industrial sector the Bloc probably can meet most of Iran's import requirements for raw and semifinished manufactures. Although they themselves are short of some key items needed by Iranian industry such as catalysts and process chemicals, Iranian demands are small. For steel products, Tehran's needs have fallen, as a result of declines in construction and manufacturing. The USSR and Eastern Europe probably would be able to meet Iranian requests for most rolled and construction steel but not for high-quality and specialty steel.

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For machinery and equipment the Bloc is a less viable option. These countries would be hard pressed, for example, to become a substitute supplier of spare parts needed to keep the transportation fleets running. Major assistance could be given in the longer run, however, if Iran chose to replace its Western inventory with Soviet Bloc equipment. The Soviet Bloc could expand sales to the power engineering, metallurgy, and agricultural-processing industries—areas in which they can provide technology close to that sold by the West.

Soviet Bloc as an Oil Partner

Iran produced an estimated 2.4 million barrels per day (b/d) of crude oil during the first quarter of 1980, of which about 1.6 million b/d were exported, including spot sales. An additional 200,000 to 250,000 b/d of refined products—mostly high sulfur fuel oil—also were sold abroad. Production and exports were at similar levels during the first half of April. Exports to Soviet Bloc countries accounted for less than 150,000 b/d. None went to the USSR.

Organizational and labor problems, and increasingly frequent sabotage attacks have been responsible for the recent decline in Iranian oil output below the 3 to 3.5 million b/d level the government apparently prefers. The Iranians also are experiencing difficulties obtaining some oil-related supplies formerly purchased from US suppliers, with acquisition of refining catalyst and other process chemicals posing the greatest problem. Reportedly oilfield plant and equipment have been kept functioning by inventory drawdowns and cannibalization of redundant equipment. Increased availability of oilfield equipment thus would have little or no impact on Iranian oil production at this time.

Even with Western sanctions, an important Soviet Bloc role in helping the Iranians sustain oil production is unlikely. For one thing, the Iranians can maintain production themselves if they can restore some modicum of order in the oil industry. Consquently, they have no immediate need for USSR or East European technicians. In the longer term, the Iranians would require parts and equipment to sustain production. Soviet Bloc capabilities for repairing and replacing Iran's oil industry equipment, however, are small. Soviet oil equipment is generally incompatible with Iran's mainly US-origin equipment, notwithstanding Moscow's recent offer to provide parts.

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To render long-term assistance the Soviets would want to bring in their own teams for exploration and development along with Soviet equipment. They have done this in other countries such as Iraq and Syria with generally poor results. The Iranians probably would balk at such a Soviet offer, preferring to acquire Western equipment through third parties. Romania—the third largest supplier of oil equipment in the world, could be more helpful to Iran and the USSR because its equipment is more compatible with Western equipment. Badly needed crude oil would provide Bucharest with a strong incentive to help the Iranians.

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The Soviet Bloc could neither absorb nor pay for anywhere near the 1.5 million b/d of oil that Iran has been exporting to the West. At current prices the oil would cost more than $20 billion. The USSR registered a record current account surplus of about $4 billion last year and could generate a surplus of at least that much this year, depending upon the level of gold sales and gold prices. The East European countries are, without exception, running hard currency current account deficits and will have difficulty financing the 500,000 b/d of oil they are scheduled to import this year.

The Soviet Union might be willing to take Iranian crude for its use or East European use as a replacement for Soviet oil to be exported to the West. Iran would have to accept a substantially lower price than at present for its oil, unless Moscow were willing to incur large losses on the deal. We doubt Iran would accept much lower prices than they have been asking; even if this meant foregoing all or most of its export revenues. The Iranians have sufficient foreign exchange reserves to carry them for at least a year.

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Appendix

The Overland Transport System to Iran

This appendix describes in detail the overland rail and road routes from the Soviet Union, Turkey, and Pakistan to Iran. The data in table A-1 are derived from the

Soviet Transport Routes to Iran

The Soviet-Iranian transport links supported about 2.5 million tons of total Iranian imports of 18 million tons a year prior to the revolution in early 1979. Soviet transport services that could be used to move goods to Iran include:

- The Trans-Siberian Landbridge for containerized cargo from Japan which handled the largest share before the revolution.
- The Transcaucasian Container Service for containerized cargo moving from Western Europe to Finland by sea and from there by Soviet railways to Iran.
- The Caspian Volga-Balt steamship line, a seasonal mixed river-sea service linking British and West European ports with Iranian ports, especially Anzeli and Nowshahr, on the Caspian Sea via the Baltic Sea, the Volga-Baltic Waterway, and the Volga River.
- A new mixed river-sea service linking Iranian ports with the Black Sea and the Volga-Don Canal.
- An international trucking service moving between Western Europe and Iran via the Soviet highway net.

Nearly all cargo shipped into Iran through the Soviet Union moves via Dzhul'fa and Astara for transshipment. The Soviet railroads that service the Iranian border radiate from the major eastern Black Sea and Sea of Azov ports of Rostov, Novorossiysk, Tuapse, and Batumi and consist of two main lines which originate at Rostov and run in a southeastern direction to Baku on the Caspian Sea. These lines basically serve the area between the Black and Caspian Seas (see map).

Table A-1

Iran: International Transportation Links Estimated Rail and Highway Capacities [1] 25X1

Location	Tons/ Day	Million Tons/ Year
USSR		
Dzhul'fa		
Highway	6,000	2.19
Rail	8,000	2.92
Astara		
Highway	6,000	2.19
Turkey		
Bazargan-Marand		
Highway	6,000	2.19
Border-Reza'iyeh		
Highway	550	0.20
Qotur		
Rail	4,000	1.46
Pakistan		
Zahedan		
Highway	1,000 [2]	0.36
Rail	1,200	0.44
Caspian Sea Ports		
Anzeli	1,300	0.47
Nowshahr	1,300	0.47
Subtotal		
Highway	19,550	7.14
Rail	13,200	4.82
Ports	2,600	0.95
Total	**35,350**	**12.90**

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[1] Capability of the overland transport systems into Iran based on traffic levels achieved prior to the present crisis. Estimated capacity in the Soviet Union is much higher. For example, the Soviet highway system leading to Iran has the estimated capacity to deliver a daily total of 76,200 tons of goods. The Soviet rail system can deliver a total of 42,000 tons of goods a day, yielding a combined total of 118,200 tons a day.

[2] This rail line is poorly maintained and is used primarily for passenger traffic.

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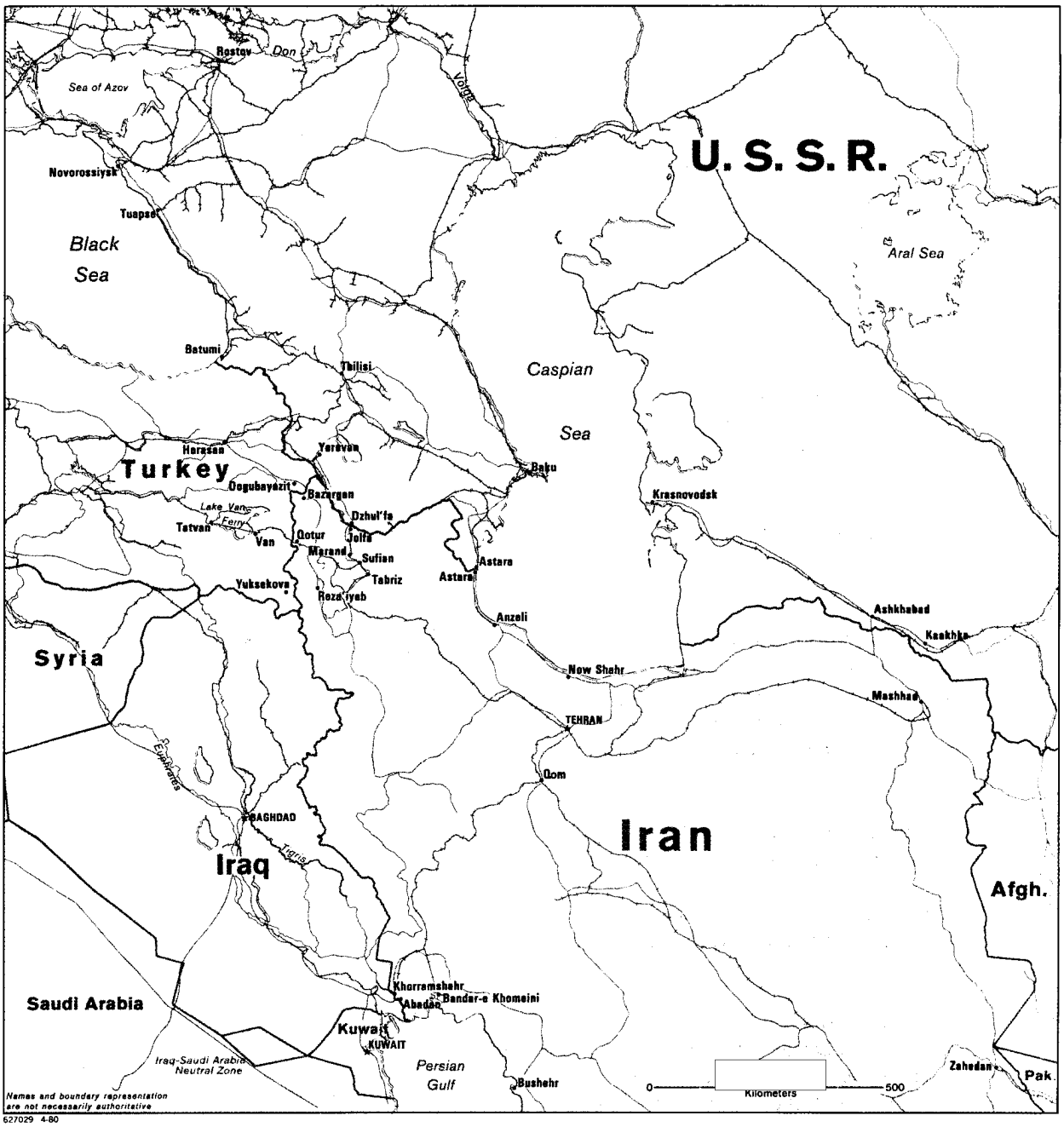

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Two major lines lead to a Soviet single-track railroad between Yerevan and Baku that skirts the Iranian border north of the Aras River. This rail line connects with the Iranian rail network at the Soviet border town of Dzhul'fa. Freight must then be transloaded in Iran from the Soviet broad-gauge to the Iranian standard-gauge system. In addition, goods can be transloaded onto trucks and continue into Iran via a major Iranian highway running southeasterly from Dzhul'fa to Tehran.

Along the western coast of the Caspian Sea, the Iranian border also is served by a Soviet single-track railroad which branches off from the main line south of Baku and runs to Astara on the Iranian border. From Astara, all goods must be loaded onto trucks for shipment into Iran via a hard surface, good capacity roadway. East of the Caspian Sea, a Soviet single-track railroad skirts the Iranian border between Askhabad and Kaakhka. Between these towns, one surfaced road and several unsurfaced roads lead to the Iranian border. Little cargo goes into Iran by this route.

Turkish Transport Routes to Iran

Major overland routes from Turkey to Iran—which in the past has carried only about 3 percent of Iranian imports—consist of one single-track rail line and two primary cross-border roads. The rail line reportedly is inoperable. One of the roads branches off the Turkish rail system more than 300 kilometers from the Iranian border and the second roughly parallels the rail line between Turkey and Iran. Both are hard-surfaced and could be used to mount a priority shuttle service by truck to the Iranian border.

The northernmost Turkish road serving Iran is the major overland highway used by truck traffic between Western Europe and Iran. The through capacity of the rail line is limited by the use of rail ferry across Lake Van, some 100 kilometers from the Iranian border (see table A-2).

Once in Iran, route capacities drop significantly. The southern road link into Reza'iyeh has recently been surfaced with bitumen but remains lightly used (see table A-3). This decrease, along with disruptions to

Table A-2 Million Tons/Year

Turkey: Capacities of Routes to Iranian Border [1]

Total	**11.6**
Railroads	
Malatya-Tatvan	1.8
Van-border	1.5 [2]
Roads	
Horasan-Dogubayazit-Bazargan-border	5.7
Tatvan-Yusekovo-border	2.6

[2] Ferry across Lake Van limits the capacity of this route to 4,000 tons per day.

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Table A-3 Million Tons/Year

Iran: Capacities of Selected Routes From the Turkish Border

Total	**6.5**
Railroads	
Border-Sufian	1.5 [1]
Tabriz	
Roads	
Border Bazargan-Marand	2.1
Border-Reza'iyeh	2.9

[1] Estimated, based on capacity of line from Turkey to border.

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internal transportation in Iran due to strikes and Kurdish activities, would further limit any increased overland movements out of Turkey into Iran.

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Current Chokepoints—The Soviet-Iranian Border

Rail traffic into Iran from the Soviet Union via Dzhul'fa and Astara—the two key overland border crossing points—involves the transshipment of goods at both locations. Should traffic levels increase significantly—especially of cargoes such as bulk foodstuffs that require additional or special handling—we would expect to see increased congestion and delays at these points.

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Capacity of the Overland Transport Routes to Iran

The capacity of the overland transport routes to Iran is estimated at 13 million tons a year. This estimate is defined as the maximum amount of traffic in tons that can be moved over a specified section of rail or road in a given period of time. The overall level of traffic derived in such capacity estimates depends on the type of logistic system involved and assumes that sufficient transport equipment and personnel are made available, that maintenance and repair of both the equipment and routes initially is at a minimum, and that the route is wholly dedicated to the specific purpose of the logistic operation.

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For highways, the key operating factors in the estimate are the availability of an adequate inventory of trucks, type of road surface, width of road and shoulders, the number of curves and extent of gradients, weather capability, and number of lanes and hours of running time. Key factors in the estimated rail capacities are the availability of locomotives and rolling stock, net trainload, train density, locomotive tractive effort, passing track lengths, grades, the use of single- or double-track lines, and the type of signaling used.

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